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MANITOBA'S POSITION ON

TAX REFORM

Honourable Howard Pawley
Premier of Manitoba

ANNUAL CONFERENCE
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MANITOBA'S POSITION ON TAX REFORM

A. Building a Fair Tax System

The Canadian tax system must be reformed.

Over the years, Canadians have become increasingly aware that the tax system no longer raises the revenues which Canadian governments need in a fair and efficient way. Incentives, preferences, and other special provisions, have accumulated and so cluttered the tax system, that it is almost impossible for ordinary Canadian taxpayers to know whether they are paying their fair share of the tax burden.

There is mounting evidence that ordinary Canadians believe the tax system is too convoluted to understand, and that people who have sufficient means are generally able to avoid most of the taxes they should pay. Too often, these perceptions are right.

Over the years, the burden of taxation has shifted from the corporate to the personal sector, and from income to consumption taxes. Within the Canadian context these trends mean that lower and middle income Canadians are paying an ever increasing share of the total taxes collected by governments.

The inequities built into the tax system have also contributed in a major way to the fiscal dilemmas faced by Canadian governments today:

- The growing gap between revenues and the resources required to finance essential public services has led to a deterioration in the quality and the accessibility of many programs. Needed program improvements have not been made, and in some cases valuable programs have been cut. Too often, lower and middle income people have borne the brunt of these actions.

- The federal government has repeatedly cited the deficit as a reason for inaction on priority issues, or worse yet cutting programs designed to assist the less developed regions of the country.

  Canadians living in the poorer provinces have suffered the most as a result of these developments. This is especially evident in the drop in regional development spending, the diminished commitment to the Equalization program, and some elements of the Established Programs Financing Arrangements.

- More recently, Manitobans have seen how, despite the stated "concern" with the federal deficit, unnecessary costs are incurred for the most dubious political reasons.

Building a fair tax system is an essential first step to resolving the social, cultural, and economic rifts and crises which are gradually eroding the cohesion and stability of the Canadian confederation.

B. Tax Reform Objectives

Manitoba agrees fully with the Report of the 1966 Carter Commission in its emphasis on fairness as the overriding objective of any tax reform effort:

> "We assign a higher priority to the objective of equity than to all the others. ... we are convinced that unless this objective is achieved to a high degree all other achievements are of little account."

A fair tax system must meet two criteria:

- Horizontal Equity: this means that people in the same economic circumstances should pay the same amount of tax.

- Vertical Equity: this means that as incomes increase, tax rates should rise.

In practice these concepts are frequently interpreted in different ways, and the term "fairness" has been greatly abused. Much of the confusion on this issue stems from a perspective which is too narrowly focussed on the constraints facing policy makers rather than the responsibilities and challenges they have been elected to address.

The Carter Commission extended its discussion of fairness beyond the issues commonly associated with taxation structures. Issues such as user charges, the levels and distribution of government services, and the responsibilities of the public and private sectors were also considered within the fairness framework. The Manitoba Government shares this perspective.

The taxes which Canadians pay to maintain essential public services are only one component of the costs faced in providing an acceptable standard of living. Public policy decisions -- on issues as diverse as patent legislation to trade relations — affect the quality of life Canadians are able to enjoy. Fair taxes are a crucial ingredient in assuring continued social and economic progress in our country.

It is sometimes asserted that the objective of fairness in tax policy can be attained only by sacrificing other important objectives such as economic efficiency. In some cases this may be true, but in general, equity and efficiency considerations lead to very similar prescriptions for reform.

The single most important component of tax reform will be developing a fair personal income tax. A comprehensive income tax base which treats all income -- regardless of its source -- as equally as possible, is essential to building an equitable tax system.

From an efficiency perspective it is often held that taxes which apply relatively high rates on narrowly defined bases, will redirect or "skew" economic acitvity by distorting the relative returns from different kinds of activities. It is also asserted that these tax-induced changes will reallocate production away from more efficient processes, and from goods and services with higher market values. From these premises, it follows that a more comprehensive tax base, with lower tax rates will also lead to higher levels of production.

In some cases it may be desirable to encourage activities which otherwise might not take place. In these situations, however, tax related inducements are only one of the many instruments which governments have at their disposal. In Manitoba's view, tax policy measures should be used only after it has been demonstrated that there are compelling reasons for preferring tax expenditures to other alternatives.

Manitoba also believes the tax system should be as simple as possible. Compliance with tax laws should be simple and the forms and procedures should be comprehensible to taxpayers.

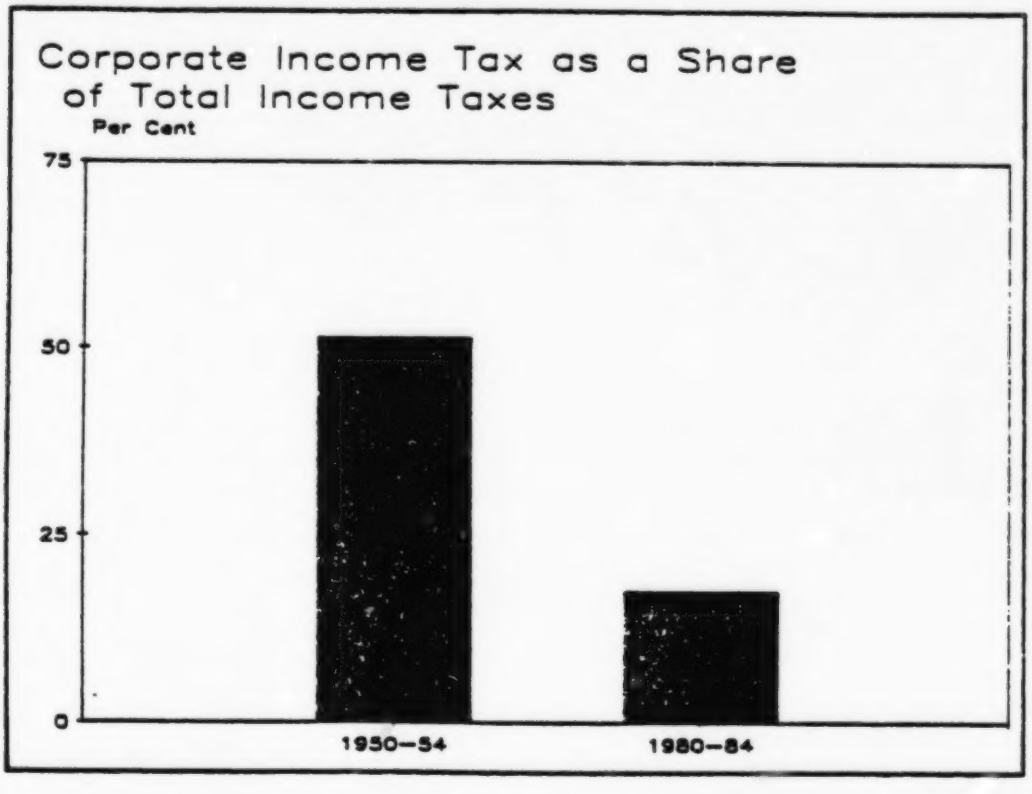
A simple system leads to greater taxpayer certainty; taxpayers must be able to complete their own returns, and have a reasonable degree of certainty that they are correct. A simple tax system would contribute to greater taxpayer understanding, and assurance that everyone is paying their fair share.

The excessive complexity of the present tax system has also resulted in higher compliance costs for taxpayers, costly and unproductive litigation, and higher administative costs for tax authorities. The creative energy now devoted to developing and restraining sophisticated tax avoidance strategies should be used more productively.

C. A Fair Share from the Corporate Income Tax

1. Declining Corporate Contributions

During the five-year period from 1950 to 1955, the corporate income tax contributed more to the federal treasury than the personal income tax. For 1986/87 corporate income taxes are less than one-quarter of total income taxes, and comprise about one-eighth of total federal revenues.



The 1986 federal Budget Address proposed changes which would further tilt the tax burden from corporations to individuals.

This trend must be reversed. Greater reliance must be placed on corporate income taxes.

2. Rate Reductions

Manitoba is, in general, supportive of the base-broadening measures introduced and pending in the "two phases" of federal corporate tax reform.

There are some aspects of these proposals which are of concern; particularly the manner in which the investment tax credit is being phased out. The differentials in the investment tax credit rates among various regions have been unfairly widened, to the disadvantage of designated regions, including Manitoba. The 60% Cape Breton Investment Tax Credit has become the focus of significant abuses.

CURRENT AND PROPOSED INVESTMENT TAX CREDIT RATES BY REGION

	Current (%)	1987 (%)	1988 (%)	1989 (%)
Cape Breton	60	60	60	60
Atlantic (includes Gaspe Peninsula)	20	20	20	20
Designated Regions*	10	7	3	0
Developed Regions**	7	5	3	0

* Includes all of Manitoba, Saskatchewan, the Yukon, the Northwest Territories; and northern/remote British Columbia, Alberta, Ontario and Quebec.

** Ontario, Quebec, urban British Columbia and Alberta.

Recent trends in the overall contribution from the corporate sector, suggest that the corporate income tax rate reductions proposed in the 1986 federal Budget Address, are not needed. A more appropriate balance between corporate and personal income taxes must be established. The base-broadening measures in the second phase of corporate tax reform should not be accompanied by further rate reductions.

3. Accumulated Incentives and Loopholes

Figures released by the federal Department of Finance show that in 1982, the value of unused losses, deductions, and preferences accumulated to that point was $18.5 billion. Some part of this total consists of genuine business losses, but a significant portion is composed of purely "tax losses" -- accelerated write-offs, tax credits or preferences which have reduced the income or taxes against which legitimate losses could be used.

In some cases the loopholes and special provisions which gave rise to the accumulated losses have already been closed or curtailed. However, measures which would reduce the extent to which these accumulated "abuses of the past" can be used to offset present and future tax liabilities should be developed and implemented. Such action is essential to ensuring that a fairer contribution from the corporate sector is obtained on a timely basis.

In 1981, almost 60% of Canadian corporations paid no income taxes. Of these non-taxpaying companies, over 46% were profitable. Manitoba has called for a minimum corporate income tax to ensure a reasonable contribution from all profitable corporations.

4. Unused Deduction Transfer Proposal

The 1985 federal Budget Address proposed a mechanism to allow corporations to transfer unused deductions and losses among related corporations. The Manitoba Government does not support any measures which would facilitate transfers of unused tax losses and deductions among related corporations in a manner which would reduce overall corporate income tax revenues; at least until the current tax loss overhang is resolved.

D. Cautious Sales Tax Reform

1. Reform Needed

The share of sales and excise taxes in total federal revenues has increased by more than 27% during the last five years. The revenues derived from these taxes are now more than the corporate income tax.

Manitoba shares many of the federal government's concerns about the structural deficiencies of the present federal sales tax. Nevertheless, it is important that the final tax reform package should not place greater reliance on this source of taxation.

2. Protection for Poorer People and Poorer Provinces

The evidence produced to date suggests that the base extensions under consideration for the Business Transfer Tax, combined with increases in the share of revenues derived from sales taxation would be regressive. Lower and moderate income Canadians would be affected most severely.

Changes in the federal sales tax may also shift the overall federal tax burden from the more industrialized, wealthier provinces, to poorer provinces with greater dependency on their resource and service sectors. This could reduce poorer provinces' ability to raise revenues from their own tax sources, and exacerbate the differences in the quality of services provided for people living in different areas of Canada.

A clearer picture of the proposed tax base, and a comprehensive examination of the regional impacts of federal sales tax reform, is required.

These observations may not represent major barriers to sales tax reform. A strengthened system of refundable sales tax credits such as those introduced in the last federal Budget, in conjunction with other measures increasing the progressivity of the personal income tax could serve as effective counterbalances to the potentially regressive impact of broadening the federal sales tax base. Strengthening the Equalization formula could serve as a viable counterbalance to inter-provincial shifts.

E. Fairer Personal Income Tax Needed

1. Equal Treatment of All Income

One of the most basic objectives of tax reform is to ensure that individuals with a similar ability to pay taxes, pay similar amounts of tax. Essentially, this means incomes derived from different sources must be assessed and taxed in such a way that the advantages of receiving income in one form or another are minimized.

2. The Capital Gains Exemption and RRSP Limit Increases

The 1985 federal Budget Address introduced a $500,000 lifetime capital gains exemption which was to be phased in over a number of years. The limit for 1986 is $50,000 — significantly more than all but a tiny fraction of Canadians will ever be able to use. The 1986 maximum RRSP deduction is $7,500; any further increases will benefit only Canadians earning more than $41,667 annually. The full $15,500 allowance scheduled for 1990 will benefit only individuals earning at least $86,111.

These changes are being defended as necessary to encourage saving and to promote "fairness." The logic underlying such assertions is questionable, to say the least.

Canadians attained and kept their personal saving rate at double digit levels over the last dozen years. The exemptions for capital gains income and deductions for pension contributions appear to have had very little to do with this.

The Canadian personal saving rate rose rapidly during 1973 and 1974. This was just after the 1972 tax reforms brought previously exempt capital gains income into the tax base, and just before RRSP limits were increased in 1976. This is exactly the opposite of what would be expected if these measures had a significant impact on saving behaviour.

The impact of these measures on taxpayer equity, however, has been very significant. The 1986 Manitoba Budget Address included an example which showed a Manitoba family of four earning $30,000 and paying $1,368 in federal income taxes after taking child tax credits and family allowances into account. At the same time a family earning $50,000 from investment sources would pay only $909 in federal taxes. This family saves $4,245 directly as a result of the last two federal Budgets.

3. Immediate Freeze on Tax Shelters

Rather than generating large tax savings for selected high income Canadians it would be more appropriate for these, and other preferences for selected sources of income, to be curtailed. The resulting revenues could be used to improve governments' fiscal flexibility, or to ensure that the total tax burden after tax reform is distributed more equitably.

Manitoba has called for an immediate freeze on the scheduled increases in the RRSP deduction limits and the capital gains exemption. The objectives for these measures should be reviewed very carefully and their effectiveness as public policy tools rigourously examined to determine whether they should be continued in their present forms.

F. Reviewing Tax Expenditures

1. What Tax Expenditures Are

The term "tax expenditures" refers to tax preferences — exemptions, deductions, exclusions, tax credits, or other mechanisms deliberately built into the tax system to achieve public policy objectives. Rather than using direct methods — grants, programs, regulation, etc. — to achieve their goals, governments sometimes choose to provide selective taxation relief in order to encourage people or businesses to alter their behaviour so as to attain the same end.

The use of tax expenditures has greatly proliferated over the last several years. In his most recent Report, the Auditor General of Canada estimated the value of income tax expenditures at $28 billion.

While using the tax system may be appropriate for some purposes, there are several important considerations which militate against using the tax system in this manner:

- The impact of selective preferences is often highly inequitable. The tax savings they create are often very large and concentrated among a small group of taxfilers. The tax savings generated are seldom related to the recipients' ability-to-pay taxes, and their distribution would not be countenanced in a direct spending program.

- The effectiveness of tax expenditures in promoting the objectives set out for them is frequently very difficult to determine. There are growing indications, however, that much of the worthwhile activity taking advantage of special tax provisions would have taken place in any case.

- The potential for major abuses appears to be growing as the attention focussed on these measures by professional tax planners increases and more sophisticated means of accessing tax benefits are developed. Since the controls on tax expenditures tend to be less stringent than on direct spending programs, the abuses will often proceed until very large revenue losses are incurred.

- There are no formal mechanisms for regular Parliamentary review of tax expenditures. This is in sharp contrast to the several stages of reviewing direct expenditures. The Auditor General has compared the control and accountability attached to direct spending programs with tax expenditures in fairly graphic terms: "At the present time the use of tax expenditures bypasses many of these controls and procedures. It is as though we had been attending to other wounds while the life blood has been flowing from severed arteries."

2. Evaluation Criteria

Manitoba believes that a number of critical questions about the usefulness of continuing tax expenditures must be answered:

- Have they resulted in more investment than would otherwise have occurred?

- Have they created more employment?

- Are they necessary for achievement of other social goals?

- What are the costs, in relation to alternative means, of pursuing these objectives?

- Are the original policy objectives still relevant or desirable?

These questions must be addressed. The evidence suggests that in the majority of cases tax expenditures are not the most effective means of pursuing economic or social objectives.

3. Review Process Needed

Manitoba has called for a systematic, regular, and thorough accounting and review of tax expenditures. This review could take any one of several forms, from a full annual Parliamentary review -- similar to the process used for direct spending programs -- to scrutiny and reporting by Parliamentary committees.

Since both the personal and corporate income tax bases are shared by the federal and provincial governments, it is important that provinces have a significant role in the review and decision-making process, insofar as it pertains to these forms of taxation.

G. Conclusion

1. Urgent Action Required

A few years ago, the Manitoba Government was virtually alone in urging the federal government to undertake a comprehensive and meaningful tax reform initiative. Now, other provincial governments are also pressing for national tax reform. And, the federal government has indicated it recognizes the need for a complete overhaul of the Canadian tax system.

In these circumstances, it is important that the process be moved along quickly and with a sense of urgency. The federal Finance Ministers' Guidelines document is a good start, but substance must follow soon. During the last several months Canadians and provincial governments have speculated and guessed at federal intentions. The need now is for substantive options, serious discussions with Canadians, and meaningful negotiations with the provinces on the issues which will determine the shape of the new national tax system.

2. Immediate and Longer Term Initiatives

The Manitoba Government has outlined a program of comprehensive national tax reform which would result in a fairer, more efficient, and productive tax system. As federal intentions become clearer and the consultative process proceeds, the concerns of Manitobans will be incorporated into the representations our Government brings forward.

Manitoba has put forward a timetable for action. This plan is designed to allow the quick implementation of interim measures needed immediately: a freeze on the capital gains exemption, RRSP limits, and the planned corporate income tax rate reductions. These measures, introduced in the last two federal Budgets, are expected to reduce federal revenues more than $3.0 billion annually by 1990 if fully implemented. Manitoba's schedule also provides sufficient time for meaningful consultations and negotiations of issues which are not as well understood, or require further review.

3. Fairness Foremost

The importance of fairness in rebuilding our national income tax system cannot be overemphasized. Canadians must be assured that each taxpayer's contribution bears an equitable relationship to that taxpayer's ability-to-pay.

Over the last few years, Canadians witnessed unprecedented abuses of the tax system, not only in terms of their total cost, but also in the concentration of the benefits among the very wealthiest individuals, families, and corporations. The Candians who could not or would not participate in these giveaways paid for them, in higher taxes, and in service cutbacks. As a nation we are contending with deficits that are higher than they needed to be.

4. Co-operation Key to Success

Tax reform touches on a critical element of any civilized nation's life -- how the functions of the state are paid for. For the process to succeed, the views and concerns of ordinary Canadians and their associations must be respected in the final outcome.

The federal government has agreed to open consultations on tax reform. This will be one of the most important items on the public policy agenda during this decade.

Any tax reform initiatives will have direct implications on provinces -- their revenues and their ability to sustain essential public services. Provinces and the federal government share responsibilities in providing services, and, to a significant extent, explicitly share the revenue bases. These arrangements provide great benefits -- in terms of flexibility, certainty, and simplicity, but without co-operation they can also entail excessive duplication, gaps, and complexity.

Action on Manitoba's call for a freeze in the capital gains exemption, the RRSP deduction increases and planned corporation income tax rate reductions would be an encouraging start for a serious tax reform effort.

Manitoba is fully committed to working with the federal government to achieve a tax system which is both fair and efficient.

Honourable Eugene Kostyra
Minister of Finance
Province of Manitoba

NOTES FOR A STATEMENT ON TAX REFORM

Finance Ministers' Meeting
Edmonton, Alberta
October 31, 1986

The vast majority of Canadians want a fundamental and long overdue reform of the tax system in our country -- and they want it soon. Mr. Chairman, I, for one, was encouraged to see that you will begin a consultative process as a first step towards attaining this critical goal.

It was appropriate that you began this process by setting out the guidelines, principles and, to some extent, expectations for this exercise. We trust the commitment given in the Guidelines paper -- that the federal government will "...consult extensively with provincial governments in an effort to ensure harmonized tax systems across the country" -- means that the input of provincial governments will be taken seriously and ultimately reflected in the outcome of the effort.

My remarks today will set out the Manitoba Government's views on basic principles, our Province's expectations in terms of the overall shape of the outcome, and our concerns with the direction and the processes of the reform effort so far.

Accordingly, Manitoba intends to contribute concretely and positively in the initiative as it proceeds.

Fairness

On reviewing your September 8 remarks in Washington, our Government was concerned that restoring fairness, the most critical shortcoming in the Canadian tax system, might not be a priority of the Canadian effort. We were relieved to see that the Guidelines paper placed more emphasis on this issue.

I especially concur with the Guidelines view that "high income individuals and profitable corporations should pay a fair share of tax." The 1986 Manitoba Budget Address included an example which showed how a Manitoba family of four earning $30,000 would pay $1,368 in federal income taxes, after taking Child Tax Credits and Family Allowances into account. Of this total, $176 is directly the result of actions initiated in the previous two federal Budget Addresses -- a 12.9% increase. At the same time, a family earning $50,000 from investment sources would pay only $909 in federal taxes. This family saves $4,245 as a result of the same federal Budgets.

Despite a history of steadily (and sometimes rapidly) increasing profits, several major banks sometimes pay less in income taxes than many middleincome Canadians.

Our Government is anxious to hear more details on the federal government's position on several outstanding questions which are closely linked to achieving the fairness objective:

1) What is the federal government's objective for the final balance between personal and corporate income taxes? During the early 1950's, the corporate and personal income taxes provided roughly equal amounts to the federal Treasury. Today, corporate income taxes are roughly 15% of personal income taxes. In Manitoba's view, progress towards the Guidelines "fair share" objective will be virtually impossible without a significant redistribution of these taxes. The trend towards less reliance on corporation income taxes must be sharply reversed.

While Manitoba is, in general, supportive of the base-broadening measures introduced and pending in the "two phases" of federal corporate tax reform, our Government is concerned that the rate reductions introduced in the 1986 federal Budget Address were inappropriate, particularly in current fiscal circumstances. If the imbalance between corporate and personal income taxes is to be redressed, the base-broadening measures in the second phase of corporate tax reform should not be accompanied by further rate reductions.

Similarly, the federal government should not proceed in introducing measures to facilitate transfers of unused and largely artificial losses and deductions among related corporations in a manner which reduces overall corporate income tax revenues.

2) Does the federal government expect to finance income tax rate reductions primarily through higher sales taxes? This has been a persistent concern of our Government and we are still awaiting clarification on this issue. While Manitoba shares many of the federal government's concerns about the structural deficiencies of the present federal sales tax, in our view the final tax reform package must not place significantly greater reliance on this source of taxation.

Our Province's reservations about significantly higher reliance on sales taxation for federal revenues centers on two concerns:

- First, most of the relevant evidence suggests that a combination of the base extensions proposed for the business transfer tax and general increases in the revenues derived from sales taxation would be regressive; lower and moderate-income Canadians would be affected more severely than higher-income individuals.
- Second, the potential inter-regional shifts in the federal sales tax burden may exacerbate the disparities in provincial tax bases and own-source revenue raising capacities. This, in turn, could only lead to greater inequities in the ways in which people living in different provinces are taxed and benefit from public services.

We recognize, of course, these are not insurmountable obstacles to a much needed reform of sales taxes. A strengthened system of refundable sales tax credits such as those introduced in the last federal Budget, in conjunction with some of the other measures which I will discuss later, could serve as effective ameliorating measures. Strengthening the equalization formula could serve as a viable counterbalance to inter-provincial shifts.

3) How comprehensively will the personal income tax base be defined? Achieving the objective of requiring "individuals with similar ability to pay taxes (to) pay similar amounts of tax" will be virtually impossible unless capital gains are taxed in a manner comparable to ordinary income and the income earned in tax sheltered RRSP and similar funds is brought into the income tax base.

Manitoba has called for a freeze on the scheduled capital gains exemption to its 1986 level of $25,000 of taxable gains and to hold the scheduled RRSP limit increases to 1986 levels.

It appears that exemptions for capital gains income and deductions for pension contributions have had little to do with Canadians attaining and keeping their

personal saving rate at double digit levels over the last dozen years. The Canadian personal saving rate jumped dramatically during 1973 and 1974. This was just after the 1972 tax reforms brought previously exempt capital gains income into the tax base, and just before RRSP limits were increased in 1976.

In our view, rather than simply generating tax savings for selected and usually high income Canadians (who in all likelihood would save just as much or more in any case) these measures should be curtailed. The revenues are needed to protect public services, or to enhance more progressive forms of tax relief.

Certainly, the objectives for these measures should be reviewed very carefully and their effectiveness as public policy tools rigourously evaluated before any further expansions are contemplated.

Revenue Stability

The growing inability of the tax system to generate sufficient revenues -- even during times of strong economic performance -- to maintain vital services for Canadians represents one of the most pressing public policy issues of the 1980's. The discussion under the "Stability" topic in the Guidelines document underscores this point.

Some of the reasons which underlie the unresponsiveness of revenues to general economic factors originate in structural changes and international events. However, much of the blame can be directly traced to the too-generous incentives, preferences and loopholes which have been introduced and allowed to proliferate over the last 15 years or so.

The Guidelines paper shows that in 1982 the value of unused losses, deductions and preferences accumulated to that point was $18.5 billion. Obviously, some part of this total consists of genuine business losses, but a significant portion is composed of artificial "partnership" losses (eg., the so-called "little Egypt bump") accelerated write-offs, tax credits or preferences which reduced the income or taxes against which these losses could be used. In some cases, the measures which gave rise to the accumulated losses have already been eliminated or curtailed.

Clearly, these accumulated "losses" present a major challenge to restoring basic fairness and revenue stability to the tax system on a timely basis. There may well be merit in exploring options to reduce the future impact of artificially-generated losses in ways which do not impact negatively on revenues now.

- A useful first step would be to examine ways in which to isolate the "genuine" component of the accumulated losses and tax credits.

- The period over which the "policy-induced" component of the losses could be used could be reduced from seven to, say, three years.

- The corporate income tax rate reductions announced in the 1986 federal Budget Address could be deferred until the total of the accumulated losses reached more reasonable levels.

These suggestions are offered simply as "thought starters." There may well be other and better means of dealing with this problem.

In the past, Manitoba has called for a minimum tax for corporations. If anything, the problem of profitable corporations paying little or no corporate income tax is even more serious than the comparable situation at the personal income tax level.

The Guidelines document appears to recognize that "other action" may well be required to raise the revenues required for governments to meet even their most essential "fiscal management and economic and social policy" obligations. It appears that an efficient expurgation of the outstanding, and largely artificial, losses may be the fairest means of moving the tax system back to a track which generates adequate revenue.

International Competitiveness

Our Government is also encouraged by the Guidelines paper's apparent recognition of the distinctive features and institutions of the Canadian economy and social structure. Any credible comparison of international tax burdens must take into consideration the realities which the Guidelines

document discusses under the "Canadian Priorities" heading:

- Equalization;
- A commitment to the "concept of social justice" implicit in our income support systems;
- Regionally-balanced economic development;
- Public delivery of health care and education; and
- The higher per capita costs of maintaining a national infrastructure for a huge country with a small population.

A recent Conference Board survey indicated that employer expenditures on health plans, private pension plans and income maintenance plans represent 20.2% of payroll costs in the U.S. and 12.8% in Canada. The major reason for the difference is the existence of services delivered by Canadian governments and financed out of tax revenues. A narrowly focussed fixation with tax rates, ignoring the benefits conferred on Canadian businesses and individuals by government delivered services, is not an appropriate perspective for developing tax policy or maintaining our distinctive heritage.

Controlling Tax Expenditures

A thorough and rigorous review of tax expenditures must be an essential component of any comprehensive tax reform. Our Government is fully committed to making the tax system, and especially tax compliance, as simple as possible. Furthermore, the tax expenditures which remain, or are introduced from time to time, must be subjected to periodic analysis and evaluation.

In his most recent Report, the Auditor General of Canada cited the 1985 federal tax expenditure account which listed income tax expenditures totalling $28 billion. Manitoba believes that a number of critical questions about the usefulness of continuing these measures must be answered:

- Have they resulted in more investment than would otherwise have occurred?
- Have they created more employment?
- Are they necessary for achievement of other social goals?
- What are the costs, in relation to alternative means, of pursuing these objectives?
- Are the original policy objectives still relevant or desirable?

These questions have not been addressed. The available evidence suggests that in the majority of cases tax expenditures are not the most effective means of pursuing economic or social objectives.

The recent National Research Council program cuts provide an instructive backdrop to a reconsideration of the SRTC program. Some estimates suggest that the SRTC may have reduced government revenues by as much as $2.8 billion during the ten months in which the program was in effect. If this amount had been new to R&D spending, our country would have met and exceeded federal targets for research spending (as a % of GDP). In fact, R&D spending in 1984 did not grow any faster than would have been expected in the absence of the program.

If even one-tenth of the revenues lost through the SRTC program had been allocated directly to Canadian scientists working in the National Research Council, in our universities and other research institutions, Canadian science policy would now be vastly more advanced.

Experiences such as this, have lead a growing number of observers; academics, several of the Nielsen Task Forces, and most recently, the federal Auditor to conclude that tax expenditures are at best, questionable solutions to the problems they are intended to address.

Unfortunately, there is no mechanism which forces tax expenditures to be scrutinized on a regular basis. A formal process for publishing and reviewing tax expenditures is an important and necessary component of the reform process.

The income tax base is shared by both federal and provincial governments. The process ultimately chosen should also include meaningful provincial input in decisions regarding tax expenditures which affect both the federal and provinces' tax bases.

Summary

To summarize, our Government strongly believes that all the conditions for a significant and successful tax reform effort are now in place. It is important that Canadian governments work together to ensure that this important opportunity does not slip by.

Tax reform is a critical component of any positive solution to the economic and fiscal challenges which Canadians and their governments face. Above all, fairness must be the overriding principle and goal. A fair tax system is essential to ensure that Canadians remain willing to contribute to maintaining and improving vital public services. This, in turn, is critical to preserving our country's unique cultural and political identity.

It is doubly important, therefore, that all eleven senior governments work cooperatively and in good faith. Manitoba has offered to participate in a positive way, and has developed several concrete proposals.

We look forward to concrete and meaningful dialogue today and in the weeks and months to come.

Honourable Eugene Kostyra
Minister of Finance
Province of Manitoba

NOTES FOR A STATEMENT
ON TAX REFORM

Finance Ministers' Meeting
Montreal, Quebec
September 19, 1986

"The first and most essential purpose of taxation is to share the burden of the state fairly among all individuals and families. Unless the allocation of the burden is generally accepted as fair, the social and political fabric of a country is weakened and can be destroyed."

This observation from the 1966 Carter Commission serves as an especially apt introduction to my remarks today. The Manitoba Government has consistently pressed for a comprehensive, thorough reform of Canada's taxation system. Our Government has always regarded fairness as the paramount consideration of any meaningful tax reform initiative.

The case for reform is particularly strong now when the collective capacities of senior governments to maintain vital services are hampered by a poorly functioning tax system.

In this regard, I read with interest the federal Finance Minister's September 5th, remarks in Washington D.C. I am pleased that the federal Finance Minister set out his understanding of the context to which the Canadian tax reform exercise must be adapted.

Those remarks serve as a good basis to identify the areas of agreement between our respective Governments and the areas which require more discussion. This meeting is an important opportunity for the federal and provincial governments to set out their principles, goals, and expectations as our country begins this critical, and too-long delayed reform.

Manitoba welcomes the recent federal announcement of its intention to commence a more complete overhaul of the three major tax sources; personal income taxation, corporate income taxation, and federal sales taxes.

We are concerned, however, that goals of tax reform must be to:

- improve fairness and equity; and
- protect the ability of federal and provincial governments to raise adequate revenues.

Areas of Agreement:

Mr. Chairman, I was encouraged by your sensitivity to the regional aspects of tax reform within the Canadian context. As far as they go, the "fundamental objectives" for a reformed tax system set out in your Washington remarks are essentially consistent with the position set out by Manitoba.

" - It should provide sufficient revenues to finance government programs;

- It must be appropriate for the economic structure of the nation;

- It must reflect the basic values of the society;

- It must maintain the respect of the taxpaying public."

We are encouraged by the apparent federal recognition of the inter-provincial aspects of the tax reform initiatives.

"Provinces have extensive consitutional responsibilities in such areas as health, education and welfare. ...This has led to joint occupation of incomes and sales tax fields and a complex set of federal-provincial fiscal and tax collection arrangements that must influence any federal tax reform proposals."

Your description of the role of government in the Canadian setting particularly in the health, education and regional development fields, is also remarkably consistent with the position set out by our Government.

> "...Canadians have overcome the handicap of a small population by pooling their resources through the state, to create the economies of scale for massive projects such as railroads and hydro facilities, as well as efficient health and educational institutions. This...means Canadians face higher taxes in exchange for lower after-tax expenditures on such things as university fees or medical insurance.
>
> ... we also use the federal government to redirect resources between regions, ...the principle of equalization is now entrenched in our constitution. ...in the form of higher federal spending levels and higher federal taxes than would otherwise be the case.
>
> ...I am well aware that the siren song of less government spending financed by a simple tax system could lead to not-so-simply resolved economic problems for residents in our have-not provinces."

Reform must ensure a fair allocation of revenues among governments to sustain public programs and services.

Finally, recognition that the federal deficit cannot be addressed without reforming "fiscal and tax structures in a coordinated fashion" is also welcomed by Manitoba.

This understanding of the task at hand, if it is respected and reflected in the final outcome, will go a long way towards creating a truly "made-in-Canada" national tax policy.

Areas of Concern:

However, the principle of taxation based on "ability-to-pay" is basic to our Government's position on both the pressing need and motivitation for comprehensive tax reform.

In an environment where the burden of taxation has relentlessly shifted from investment to labour

income, and from the corporate to the personal sector, an unequivocal commitment to equity would -- in my opinion -- be entirely consistent with reflecting "the basic values of the society," and with maintaining "the respect of the taxpaying public."

The issue of basic fairness; the concept of each taxpayer bearing his or her fair share of the tax burden, was conspicuous by its absence in the federal description of the "fundamental objectives" of tax reform.

We do not accept the conclusion that the Canadian situation "shapes" the tax reform priorities so that sales taxes take on a "central role" in the reform effort.

In our view, income tax reform will be the most critical element of any meaningful reform effort. Income tax constitutes the largest single source of both federal and provincial revenues, it is also the tax which touches Canadians the most immediately, and is virtually the only tax directly based on ability-to-pay.

This means that the central criteria for fairness is the equal treatment of income: regardless of source, and regardless of use. In other words, a buck-is-a-buck.

Our Government believes the recently introduced inequities in the personal income tax; the $500,000 capital gains exemption and the increased RRSP contribution limits at a cost of more than $2 billion annually by 1991, are a significant step in the wrong direction.

To date, we have seen no evidence that the capital gains exemption is achieving its stated economic objectives, and the cost in terms of equity is quite simply appalling. As long as this measure remains in place the tax burden on ordinary working Canadians will be too high.

We are also concerned with the scheduled increases in the RRSP contribution limits for high-income Canadians. Surely, we are not concerned that individuals with incomes of more than $42,000 will not save adequately for their retirement years without tax inducements. As the Minister is aware the Canadian saving rate has been significantly higher than in the

U.S. for more than the last decade, yet, the U.S. tax reforms are restricting rather than expanding tax incentives for saving.

My point is simply that we should not "red-circle" certain tax provisions as being immune from the reform process.

The federal Auditor has estimated that the annual value of tax expenditures may be as high as $50 billion. A complete review of the effectiveness of all tax expenditures is long overdue:

- Have they resulted in more investment than would otherwise have occurred?
- Have they created more employment?
- Are they necessary for achievement of other social goals?
- Are the original policy objectives still relevant or desireable?
- What are the costs, in relation to alternative means, of pursuing these objectives?

Until now these questions have not been adequately addressed. The evidence which is available -- while incomplete -- is not supportive of the contention that tax incentives are an effective means of pursuing economic and social policy objectives.

In the interim, our Government would strongly urge the Minister to freeze the lifetime capital gains exemptions and the RRSP contribution limits at their 1986 levels.

Conclusion:

In recent years the income tax system has not produced the revenues required to maintain essential public programs. Vital services have been cut and taxes unrelated to ability-to-pay have increased. This has resulted in ordinary Canadians; both working and retired, paying an increasingly inequitable share of taxes, and absorbing cutbacks in services.

Canadians have repeatedly indicated that they want essential services; health, education, and income security, maintained -- not cut back. They have also indicated their willingness to pay their fair share of the revenues needed to deliver these services. There is no question that sweeping changes are required to ensure fairness in our tax system.

To summarize, as tax reform efforts will intensify at both senior levels of government, it is critical that Canadian Governments approach this issue positively and work towards a fairer and more efficient tax system.

Honourable Howard Pawley
Premier of Manitoba

NOTES FOR A STATEMENT

ON FEDERAL-PROVINCIAL FISCAL RELATIONS

Provincial Premiers' Conference
Edmonton, Alberta
August 10 to 12, 1986

Introduction

I am pleased to have this opportunity to lead off our discussion of federal-provincial fiscal relations. As all of us at this Conference know, fair and equitable fiscal arrangements, involving both the sharing of the revenue base and federal transfers are necessary to ensure that provinces have the capability of meeting their responsibilities and of adequately serving the needs of Canadians across the nation.

In the forefront of federal-provincial fiscal issues this year are:

- the provision of adequate funding for health and higher education;
- equalization and regional development; and
- tax reform.

These are important questions with implications for all Canadians. How federal and provincial governments deal with these issues now will have significant effects on social and economic development throughout Canada for the balance of this century.

Health and Higher Education

Last year in St. John's, Newfoundland, Premiers unanimously rejected federal proposals to cut federal support for health and higher education programs. Our communique noted and I quote:

> "federal cutbacks are clearly inconsistent with maintaining present levels of service, let alone meeting projected needs."

Similar conclusions were reached by the Nielsen Task Force.

And there is the continuing reality that poorer provinces have a more difficult time finding resources to compensate for federal cutbacks while maintaining competitive tax levels and other economic and social development initiatives.

Regrettably, the federal government turned a deaf ear to the provinces and to concerns of men and women throughout the country and proceeded unilaterally with cutbacks in support for health and higher education.

However, the long-term consequences of inadequate federal funding are still ahead of us. There is still time to act to protect and enhance health and higher education services to meet the needs of all Canadians.

Last year, U.S. health care spending increased to 10.7% of GNP from 10.4% in 1984, to meet the increasing demands and needs of citizens, and especially the rapidly increasing numbers of senior citizens, for health care services.

While Canadian health care is more efficient and effective, we are facing a similar increase in needs and similar underlying cost trends to those evident in the United States and elsewhere.

Federal Health Minister Jake Epp has indicated that he will present a health strategy paper in November, some eight months after the federal cutbacks started to take effect. We deplore this "cut-first, plan-later" approach. Nevertheless, Manitoba continues to believe that a national planning process to identify needs, appropriate program stategies and fiscal requirements is crucial. We are prepared and anxious to meet with the federal and other provincial governments for this important purpose.

Health Ministers and the Council of Ministers of Education will hold meetings in September. We could direct these Ministers to provide further information on the requirements of Canadians for health and higher education services and on means of assuring the needed resources. A preliminary report could be requested prior to the First Ministers' Conference in November.

For all these reasons, it is important that First Ministers revisit the health and higher education funding issue in November, including the Alberta suggestion that the provisions of Bill C-96 must be treated as a temporary measure. This could avert long-term damage to fundamental services.

Equalization and Regional Development

Earlier, we discussed regional development broadly, in the context of the economy. Success in our commonly held goal of ensuring equitable development throughout Canada requires that the regional dimension of all federal activity be examined carefully and where possible improved and strengthened.

The importance to the regions of Canada of federal initiatives in many program sectors including agriculture and transportation is very great, as are co-operative efforts through regional development agreements and direct federal purchasing and activity.

It is no accident that the constitutional commitment to equalization is alongside the commitment to regional development in Part III of the Constitution. The commitment to Equalization is to ensure that provinces can provide "reasonably comparable levels of public services at reasonably comparable levels of taxation." Clearly that is crucial to regional development just as policies to foster balanced

regional development are crucial to the capacity of provinces to provide adequate services with competitive taxes.

As is well known, the equalization formula imposed in 1982 substantially reduced basic equalization entitlements of provinces. The current formula leaves recipient provinces some $850 annually for a family of four short of the all-province average capacity to raise revenue. The wide divergences in tax levels and rates resulting from these shortfalls are a concern.

Fundamental changes are necessary, including, in our view, raising the standard of equalization from the current five-province, so-called "representative average," imposed in 1982 to the all-province national average. Such a change becomes even more crucial if the health funding cutbacks are not rescinded. We could direct our Finance Ministers to develop formula changes and other options to reflect a strengthened commitment to equalization.

Tax Reform

Manitoba has long advocated comprehensive tax reform to:

- improve fairness and equity;
- protect the ability of federal and provincial governments to raise adequate revenues to maintain vital services;
- further goals of effectiveness, efficiency and simplification.

The recently stated federal intention to reverse the long-term shift of taxation from the corporate sector to the personal sector is consistent with the position Manitoba has taken over the years. And, the recent federal commitment to comprehensive reform is welcome.

The case for reform is strong, and never stronger than now when governments' collective capacity must be protected. Returning to a tax system akin to that of 1961 would not be reform.

At times, the federal government has linked its discussions of tax reform to providing tax rates "competitive" with those in the United States. We should be careful in making such comparisons, to take into account differences in social services. For example, Canadian taxes pay for Medicare, while Americans must be provided with medical coverage through the workplace or from their pay cheques. Tax levels set "competitive" with U.S. taxes would not provide adequate funds to continue Medicare.

We need a "made in Canada" policy which recognizes the advantages the country has because of our social heritage.

Provinces have a vital interest in tax reform and must be involved in formulation of options and objectives. Finance Ministers should be directed to report back to us on tax reform before the First Ministers' Conference.

Summary

To summarize, Canadians need and deserve fair and secure financing for essential health and higher education programs. As a nation, our commitment to equalization and regional development should be strengthened. Tax reform is urgently required to support our economic and social goals.

These issues are interlinked. The provinces have a vital concern in each area. First Ministers, Ministers of Finance and Ministers responsible for key program areas must be involved. Much work can be done on these issues prior to the First Ministers' Conference in November.

The pillars of federal-provincial fiscal arrangements must be strengthened if the Canadian federation is to stand firm and continue to provide a good and secure home for all of our citizens.

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27TH ANNUAL PREMIERS' CONFERENCE

Communique on Federal-Provincial Relations/Tax Reform

August 10-12, 1986
EDMONTON, Alberta

27TH ANNUAL PREMIERS' CONFERENCE
Edmonton, Alberta
August 10-12, 1986

COMMUNIQUE ON FEDERAL-PROVINCIAL RELATIONS/TAX REFORM

The Premiers reviewed the state of federal-provincial relations and noted the need for joint planning for the 2nd Annual First Ministers Conference to be held in November, 1986. The Premiers welcomed the Annual First Ministers Conference as an opportunity to discuss, cooperatively, matters of mutual concern.

FEDERAL-PROVINCIAL AGREEMENTS

Premiers recognized that Federal-Provincial agreements and arrangements have become an important instrument of government. They expressed concern that unilateral changes to these agreements and arrangements are very disruptive. In particular, they noted the recent changes to the Fiscal Arrangements Act. Premiers suggested that the development of mechanism to give greater certainty to such arrangements be explored.

They view the current reduction in the growth of federal transfers for social programs as a temporary measure and reiterated the importance of adequate federal funding for these programs.

The Premiers called on the federal government to ensure that the equalization program meets the Constitutional commitment to enable provinces to provide "reasonably comparable levels of public services at reasonably comparable tax rates".

They concluded that agreements on fiscal arrangements should be a major topic on the agenda of the First Ministers Conference in Vancouver.

TAX REFORM

The ten provincial Premiers welcomed recent federal statements committing the federal government to comprehensive tax reform. Premiers agreed that the implications for major provincial taxes must be considered. They noted that the federal commitment was consistent with earlier statements by the Premiers which stressed the need for tax reform to improve fairness and simplicity in taxation.

The Premiers identified economic development and competitiveness as vital objectives which must also be served, while recognizing the revenue requirements to finance national social programs. The impact on employment as well as on regional and sectoral economic strengths will be important criteria for assessing tax reform options.

The Premiers noted that important social objectives are met through both direct social programs and taxation policies. They agreed that tax reform should be truly comprehensive and improve harmony between taxation and expenditure programs.

The Premiers stressed that tax reform must not be used by the federal government as an excuse to erode provincial health and post-secondary education support by further cutbacks in transfer payments.

The process of tax reform must be open to consultation among all Canadians. But they agreed that it can only be successful with the co-operation of the provinces, since provincial taxes form an important part of the country's revenue system. The Premiers emphasized the need for federal-provincial consultation, co-operation and consensus building. They recommended that tax reform be on the agenda of this November First Ministers Conference. They directed their finance ministers to meet in preparation for that discussion.